

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

February 27, 2009

RE: Rates of Return and Rates of Margin for Class C and D Water Utilities

TO: COMMISSION

By this memorandum, the Division of Water and Audits (DWA) updates its recommended Rates of Return and Rates of Margin for Class C and D water utilities.¹ These updates have been calculated in accordance with Resolution W-4524, which revised the Standard Practice that addresses how the rate of return and rate of margin are calculated for Class C and D water utilities.

DWA considered a number of factors in determining the rates of return. DWA assessed the movement in actual and forecasted interest rates over the last year's (lower actual rates that are forecast to recover to near recent historical). In addition, DWA took into account the high operational risks faced by Class C and Class D water utilities and the constant level of authorized rates of return for Class A water utilities in 2008 over 2007 (average of 8.95% and 8.94%, respectively).

In determining the rates of margin for Class C and D water utilities, DWA considered the Class B water utilities most recent authorized average rates of return of 9.68%, their most recent imputed rates of margin of 17.58%, and the recommended rates of return for Class C and D water utilities, as calculated above.

For 2009, DWA recommends that the following rates of return and rates of margin be used for Class C and Class D water utilities informal general rate cases (supporting documentation is attached):

	Rates of Return (ROR)	Rates of Margin
Class C	12.00% to 13.00%	23%
Class D	12.75% to 13.75%	24%

If you have any questions regarding the Rates of Return or Rates of Margin recommendations, please contact Sean Wilson of the Division of Water and Audits (1-415-703-1818, smw@cpuc.ca.gov).

Sincerely,

Ramf Kahlon
Director, Division of Water and Audits
Kayode Kajopaiye, Chief
Utility Audit, Finance, & Compliance
Branch

Attachment

¹ As required by D.92-03-093, in Phase I of I.90-11-033 (Water Risk OII).

CALCULATION OF CLASS C & D WATER COMPANY² RATES OF RETURN (ROR) & RATES OF MARGIN (ROM)³

- Rates are calculated using both return-on-ratebase and operating ratio methods.
- The method that produces the higher result is used.
- ROR is set at a level above or below the recommended ranges, if warranted.
- Where little or no rate base exists, the ROM is used.
- The ROM is applied to Operating Expenses to determine the estimated dollar return, which is then compared with the average dollar ROR on rate base.
- Calculations are based on the assumption that there is a comparable relationship between authorized Class B ROR and ROM and Class C and D ROR and ROM.
- Class C and D water operations, finances, and risks are more similar to those of the Class B water companies, than with Class A water utilities.

Data Use in the Determination of the Rates of Return and Rates of Margin

Year	Recommended ROR Range		Actual Interest Rates from the Federal Reserve			
	Class C Water	Class D Water	90-day Treasuries	1-Year Treasuries	5-Year Treasuries	30-Year Treasuries
2007	12.10% - 13.10%	12.85% - 13.85%	4.48%	4.53%	4.43%	4.84%
2008	12.00% - 13.00%	12.75% - 13.75%	1.40%	1.83%	2.80%	4.28%
2009 (as of 02/09)			0.13%	0.44%	1.60%	3.13%
Forecast for 2010 (As of 02/09)			Forecast Interest Rates from DRI			
			0.84%	1.14%	2.30%	3.78%

Calculation of Rate of Margin	Inputs	Class C ROM	Class D ROM
Avg Class B Rate of Margin (ROM)	17.58%		
Avg Class B Rate of Return (ROR)	9.68%		
Avg Class C ROR	12.50%		
Avg Class D ROR	13.25%		
Avg Class C ROM = Avg Class B ROM * (Avg Class C ROR/Avg Class B ROR)		23%	
Avg Class D ROM = Avg Class B ROM * (Avg Class D ROR/Avg Class B ROR)			24%

² Class C water utilities have 501 to 2,000 customers, Class D water utilities have 500 or less customers.

³ Pursuant to D.92-03-093, Ordering Paragraph 8 and Resolution W-4524.